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TAGS: ECON EFIN EINV ETRD LO
SUBJECT: STRONG MACRO PERFORMANCE KEEPS SLOVAKIA ON TRACK FOR EURO IN 2009

¶1. SUMMARY: Slovakia's Statistical Office recently reported that the Slovak economy grew 9.4 percent in the second quarter of 2007. The swift economic growth was reflected also in higher salaries and lower unemployment. The average real wage increased 4.1 percent to 19,600 SKK (USD 795) in the second quarter, but is still outpaced by strong productivity growth. Salaries in Slovakia should soon break through the 20,000 SKK threshhold, also without the "Christmas bonuses" that the Fico government awarded last year. Unemployment in the country fell to 11.5 percent and registered unemployment reached 8.3 percent, the lowest figure since 1996. EU norm harmonized inflation dipped to 1.5 percent, the lowest in the country's 14 year history. Analysts believe Slovakia is on track to join the Euro in January, 2009. END SUMMARY

NATIONAL BANK CONFIRMS STABILITY OF GDP GROWTH
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¶2. The National Bank of Slovakia noted that the recent economic growth at 9.4 percent in the second quarter represents no danger of creating economic imbalances or overheating. The primary reason is that real wage growth, reported at almost 4 percent for the quarter, continues to be lower than the growth of labor productivity. The Statistical office of the Slovak Republic updated its predictions for the whole year 2007, including expected GDP growth at 8.8 percent, average inflation at 2.5 percent, unemployment rate at 10.8 percent, employment growth at 2.3 percent, average nominal monthly wage growth at 7.2 percent up to 20,120 SKK (USD 815) and real wages growth at 4.6 percent.

INFLATION THIRD-LOWEST AMONG EU COUNTRIES

¶3. Slovakia had the third lowest inflation rate among all EU member states in July 2007, reaching the historical low of 1.2 percent (following inflation in Malta -0.2 percent, Denmark 1.1 percent and France 1.2 percent). Twelve month average inflation decreased from 3 percent to 2.7 percent, and despite predictions, missed fulfillment of the Maastricht required 2.6 percent by 0.1 percent. The National Bank of Slovakia expects national inflation to reach 2.6 percent within the next month. The low inflation figures have been driven in part by the strong Slovak Koruna, which has appreciated almost 9 percent against the Euro in the first two quarters of the year.

WALKING TOWARDS EURO ADOPTION

¶4. With inflation forecast at 2.6 percent next month, Slovakia will meet the Maastricht criteria well ahead of expected Euro adoption in
¶2009. Despite these excellent macroeconomic numbers, which are widely seen as a result of the structural reforms implemented by previous Dzurinda government, the current GOS has recently been accused by the media of not implementing the necessary programs and policies to adequately support Euro adoption in 2009. For example, the public tender for the Euro public relations campaign was twice

cancelled and re-opened because of questions relating to the transparency of the process. The opposition has played up these mistakes, as well as recent legislative initiatives that will increase costs on employers, to make it clear that the blame for any delay would fall to the current government. Despite the media speculation, there have been no indications that the government has changed its oft-repeated policy that Euro adoption in 2009 is among its top economic priorities.

¶5. It is widely accepted by local analysts that the final decision by the European Union will be as much a political decision as an economic one. The case of Latvia, where Euro adoption was delayed due to the country being over its inflation criteria by 0.1 percent, is oft-cited in the Slovak press. Nevertheless, analysts stress that the EU's independence and competence would be seriously endangered, if, in case of Slovakia, the EU were to make a political decision to delay Euro adoption despite excellent macroeconomic results. The Ministry of Finance and National Bank of Slovakia continue to see Euro adoption for Slovakia in 2009 as the only existing alternative.

FDI INFLOW HIGHEST-EVER

¶6. Slovakia recorded the highest-ever FDI inflows in 2006, reaching 4.2 billion USD (based on OECD statistics). These numbers to some extent reflect cross-border takeovers, but to a greater extent represent additional investment by foreign companies with existing operations in the country. In the case of Slovakia the figures were boosted by a large takeover in the energy sector by Italian company Enel, which is responsible for one-fourth of total flows. With the Fico government having put a stop to all privatizations, this number is expected to drop significantly in 2007. However, there have been recent rumors in the press that Ford is considering a large investment in Eastern Slovakia.

¶7. The GOS approved a new Act on Investment Incentives, drafted by Ministry of Economy, which for the first time provides equal treatment to foreign and domestic investors. The incentives are available to varying decrees depending on the region and type of investment, with higher value-added industries and the less developed eastern part of the country as the highest priorities. This is an interim law that will be updated again in early 2008, when a new and more detailed Act on Investment Aid, designed to meet EU criteria for incentives and thus simplify the overall process for investors, is expected to be approved.

NATIONAL STRATEGIC REFERENCE FRAMEWORK APPROVED BY BRUSSELS
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¶8. The European Commission approved Slovakia's National Strategic Reference Framework for 2007-2013. This document is the strategic plan for utilizing European Union structural funds and identifying key priorities, reflecting the Lisbon strategy objectives: convergence, regional competitiveness and employment, and European territorial cooperation. Slovakia will be eligible for drawing 11.587 billion EUR in 2007-2013, and will be required to co-finance the projects with national public sources (state budget, regional budgets) and private sources. Consequently, 11 operational programs will be approved in the coming months, outlining concrete strategic areas for the projects.

¶9. COMMENT: Slovakia's strong economic performance is expected to continue through the remainder of the year and into 2008 as new investments continue to come on line. Despite recent murmurings in the press, most analysts remain confident that the Maastricht economic criteria will be fulfilled in the coming months. Recent changes to the Labor code and proposed amendments to the Act on Social Insurance, though having only relatively minor impacts on business, have nevertheless resulted in a more negative view of the business environment in Slovakia (according to a recent survey by the Business Alliance of Slovakia) and have stoked skepticism about Fico's long-term commitment to the flat tax and other economic reforms of his predecessor, especially after Slovakia enters the Euro zone. END COMMENT.